LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
http://www.in.gov/legislative

FISCAL IMPACT STATEMENT

LS 6289
BILL NUMBER: HB 1029

NOTE PREPARED: Jan 30, 2006
BILL AMENDED: Jan 30, 2006

SUBJECT: Education Finance and Tax Credits.

FIRST AUTHOR: Rep. Buell
FIRST SPONSOR:

BILL STATUS: 2nd Reading - 1st House

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: (Amended) ***College Savings Plan Deduction:*** The bill provides that up to $2,000 in contributions to an Indiana College Choice 529 Investment Plan or other qualified tuition program may be deducted from Adjusted Gross Income.

Validation of Bonds: The bill changes the date for validation of all outstanding bonds issued or lease agreements executed by various governmental entities from March 15, 2000 to March 15, 2006.

University Bond Issuance: The bill adds software and related capital costs for the operation of a building facility to the costs that may be included in a state university's bond issue. It provides that certain installment contracts entered into by state universities are exempt from certain requirements governing bond issues. The bill increases the cap on the amount of bonds that a state university may have outstanding for qualified energy savings projects from $10,000,000 to $20,000,000. It permits the following bonds to be issued without the prior approval of the general assembly: (1) Bonds issued by any state university for equipment, software, and other capital purposes. (2) Bonds issued by Purdue University for deferred repair and rehabilitation expenses. (3) Bonds issued by any state university for certain technology expenditures. The bill permits refunding bonds to be issued without the approval of the state budget committee and the governor. The bill authorizes Indiana University and Purdue University to issue revenue bonds for facilities if: (1) the facilities are at the West Lafayette, Indianapolis, or Bloomington campuses; (2) the facilities are used for clinical, medical, scientific, engineering, or other similar research purposes; and (3) revenue will be available in an amount at least equal to debt service for the bonds. The bill gives legislative approval to Indiana State University for bonding for a student recreation center project.

Employer Health Benefit Plan Tax Credit: The bill allows certain employers to take a tax credit related to making a health benefit plan available to the employers' employees. The bill makes related changes.

Effective Date: Upon Passage; March 15, 2006 (retroactive); July 1, 2006; January 1, 2007.

Summary of Net State Impact: (Revised) The estimated net impact of the bill is summarized in the table below:

Source	FY 2008	FY 2009	FY 2010	FY 2011
College Savings Plan Deduction	(0.29 M)	(0.3 M)	(0.32 M)	(0.34 M)
Employer Health Benefit Plan Tax Credit*	(0.6 M)	(0.6 M)	(0.6 M)	0
Employee Health Benefit Plan Premium Exclusion**	0	0	(4.3 M)	(4.3 M)
Insurance Premiums Tax	1.5 M	1.5 M	1.5 M	1.5 M
Net Revenue Gain (Loss)	0.6 M	0.6 M	(3.7 M)	(3.1 M)

*Tax credit affects the Adjusted Gross Income Tax, Financial Institutions Tax, and Insurance Premiums Tax.
**Exclusion affects the Individual Adjusted Gross Income Tax.

The estimated revenue loss noted in the table above due to the College Savings Plan Deduction is attributable only to deductible contributions to Indiana College Choice 529 Investment Plan accounts. This estimate is based on 2004 account data and assumes annual growth of 5%. It is important to note that the impact of this deduction as it applies to contributions to other 529 college savings and prepaid tuition plans is indeterminable. The estimated impact of the Employer Health Benefit Plan Tax Credit assumes that all qualified employers currently not offering health benefits do so initially in 2007 and claim the employer health benefit plan tax credit in 2007 and 2008 (with carryover credits claimed in 2009). Depending on the extent that employers in this cohort delay initially offering health benefits to employees until years after 2007, some portion of the FY 2008-FY 2010 fiscal impact (tax credits, premium exclusions, and premium taxes) could be shifted to a later period. In addition, the fiscal impact (tax credits, premium exclusions, and premium taxes) in FY 2009 and after could be increased somewhat if additional employers with 10 or more employees arise due to business start-ups or business expansions in 2008 and after.

Explanation of State Expenditures: ***Department of State Revenue (DOR):*** The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the tax changes proposed in this bill. The DOR's current level of resources should be sufficient to implement these changes.

Validation of Bonds: Under existing law, all bonds, notes, evidences of indebtedness, leases, or other written obligations issued by or in the name of any state agency, county, township, city, incorporated town, school corporation, state educational institution, state-supported institution of higher learning, political subdivision, joint agency created under IC 8-1-2.2 (which involves municipal electric utility programs), leasing body, or any other political, municipal, public or quasi-public corporation or in the name of any special assessment or taxing district; or in the name of any commission, authority, or authorized body of any such entity; and any pledge, dedication or designation of revenues, conveyance, or mortgage securing these bonds, notes, evidences of indebtedness, leases, or other written obligations are hereby legalized and declared valid if these bonds, notes, evidences of indebtedness, leases, or other written obligations have been executed before March 15, 2000.

The bill provides that in addition to the above-listed debt instruments, swap agreements and other agreements are legalized. Additionally, the bill includes "boards" with respect to entities to which the provisions apply. The bill further extends the deadline before which the debt instrument must have been executed, from March 15, 2000, to March 15, 2005.

Essentially, these provisions legalize the above-mentioned products. Without the provision, if, for example, a bond was issued without providing the appropriate notice, the bond could be invalidated. The above provisions make the issuer or the entities involved not liable. For example, IC4-4-11-17 provides that the Indiana Finance Authority must hold a public hearing on the proposed financing agreement for an industrial development project after giving notice by publication in one newspaper of general circulation in the city, town, or county where the industrial development project is to be located at least ten days in advance of this public hearing. Under the bill, if the notice was given only six days in advance of the public hearing, the Authority could not be held liable and the bond would not be invalidated.

(Revised) ***University Bond Issuance:*** The bill would increase the ability of state colleges and universities to bond for projects. The increase in bonding capacity is unknown. The state is scheduled to pay about $131.1 M in fee replacement debt service payments for FY 2007. If the increase in bonding is for projects eligible for fee replacement, then there could be an increase in General Fund expenditures subject to appropriations. The provisions of the bill include the following.

(1) The bill authorizes the trustees of Indiana University and Purdue University to issue bonds without the approval of the General Assembly to construct and equip research facilities at the Purdue University-West Lafayette, IUPUI-Indianapolis, and Indiana University-Bloomington campuses, provided research activities at these facilities will generate revenues from various sources at least equal to the annual debt service for the outstanding bonds. As a result, this provision will not require fee increases by, or increases in state funding to, the universities for purposes of financing these projects.

(2) The bill authorizes the trustees of Purdue University to issue up to $60 M in bonds without the approval of the General Assembly for repair, rehabilitation, remodeling, renovation, or reconstruction of existing facilities or buildings; for improvements or replacement of utilities or fixed equipment; or for performing related site improvement work.

(3) The bill authorizes the trustees of Indiana State University to issue up to $24 M in bonds to construct, furnish, and equip a Student Recreation Center. The bill specifies that the project is not eligible for fee replacement.

(4) The bill increases the cap on the value of notes issued by a state university in anticipation of a grant the state university is to receive from the federal government, the State of Indiana, or a private entity for acquisition, improvement, renovation, construction, or support of building facilities. Under current statute, the value of the notes may not exceed 80% of the estimated value of the grant. The bill raises this limit to 100% of the estimated value of the grant.

<u>Explanation of State Revenues:</u> (Revised) ***College Savings Plan Deduction:*** The deduction would reduce state Adjusted Gross Income (AGI) Tax liabilities for individual taxpayers who make contributions for dependents to: (1) Indiana College Choice 529 Investment Plan accounts; or (2) other 529 colleges savings or prepaid tuition plan accounts. The revenue loss due to the deduction for contributions to Indiana College Choice Plan accounts could potentially total about $290,000 in FY 2008, with the revenue loss estimated to increase by about 5% annually thereafter. The revenue loss due to the deduction for contributions to other 529 college savings or prepaid tuition plans is indeterminable, but could potentially be significant given the number of plans sponsored by other states, and by private colleges and universities nationwide.

Background: The bill establishes an AGI deduction for individual taxpayers who make contributions to: (1) an Indiana College Choice 529 Investment Plan account for a dependent; or (2) to another qualified tuition program that is exempt from federal income taxation under Section 529 of the Internal Revenue Code (IRC) for a dependent. The deduction is equal to the lesser of either the taxpayer's contribution to the account during the taxable year or $2,000. The bill also limits the maximum deduction for joint filers to $2,000 annually. For a taxpayer claiming the full $2,000 deduction, this would effectively reduce his or her annual income tax liability by $68. Since the deduction is effective beginning in tax year 2007, the fiscal impact would begin in FY 2008. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of the revenue is deposited in the Property Tax Replacement Fund.

The estimated revenue loss from deductible contributions to Indiana College Choice Plan accounts is based on account and contribution totals for the Plan. In 2004, approximately 2,096 Indiana account holders contributed in excess of $2,000. A total of 1,375 Indiana account holders contributed between $1,000 and $2,000, with the average contribution totaling about $1,337; and 5,473 Indiana account holders contributed less than $1,000, with the average contribution totaling about $239. Had the $2,000 deduction existed in tax year 2004, deductible contributions could have totaled about $7.3 M, with a tax impact of about $250,000. Based on account information from prior years, the estimate for tax year 2007 (the first year of the proposed deduction) assumes that deductible contributions grow by about 5% annually. The impact of the deduction could potentially be lower depending upon the number of accounts where the beneficiary is not a dependent of the owner.

Under the IRC, a qualified 529 plan is a program under which a person may prepay tuition credits or make cash contributions to an account on behalf of a beneficiary for payment of qualified higher education expenses. The program must be established and maintained by a state, state agency, or by an eligible educational institution, including a private college or university. Eligible schools generally include any accredited post-secondary educational institution provided contributions are held an IRC-qualified trust. There are currently 322 private colleges with prepaid tuition plans that are members of the Independent 529 Plan organization, 11 of which are located in Indiana. In addition, every state and the District of Columbia currently operates a 529 college savings and/or prepaid tuition plan, with a total of 121 separate plans currently operated by states.

Employer Health Benefit Plan Tax Credit: The employer health benefit plan tax credit established by the bill could potentially reduce revenue from the Adjusted Gross Income (AGI) Tax, Financial Institutions Tax, and Insurance Premiums Tax beginning in FY 2008. The estimated reduction in revenue due to the tax credit is discussed below under the section *Health Benefit Plan Credit/Premium Exclusion Impact.* The health benefit plan credit could potentially have the following two additional impacts on Insurance Premium Tax revenue and revenue from the Individual AGI Tax.

(1) After the first two years that employees participate in a health benefit plan provided by an employer

receiving the tax credit, premiums paid by the employee will be excluded from Indiana AGI. This is expected to decrease AGI tax revenue from these individual taxpayers. This impact is discussed below under the section *Health Benefit Plan Credit/Premium Exclusion Impact*.

(2) The health benefit plan credit also could potentially increase revenue from the Insurance Premiums Tax as more insurance policies are underwritten in the state. The increase in Insurance Premium Tax revenues may partially mitigate the impact of the AGI exclusion. The extent of this offset, however, depends on the amount of Insurance Premium Tax credits that health insurance companies currently take and carry forward.
This impact is discussed below under the section *Insurance Premiums Tax Impact*.

The following assumptions are used to estimate the impact of the health benefit plan credit: (1) All employers of 10 or more employees that currently don't offer a health benefit plan, do so and claim the tax credit; (2) 10% of employees participate in the health benefit plan offered by these employers; (3) participating employees are currently uninsured or not insured by another policy; (4) employers offering a health benefit plan for the first time as a result of the credit require participating employees to pay all of the premium costs; and (5) employees pay health insurance premiums with "pre-tax" dollars (amounts excluded from federal AGI). (Note: A 10% employee participation rate may be conservative given that recent survey research suggests that over 83% of workers in firms offering health benefits participate in the health plan. However, it is assumed that participation rates will be limited if employees pay the full premium cost of the health benefit plan.)

Health Benefit Plan Credit/Premium Exclusion Impact: The estimated impact of the health benefit plan credit to employers and the exclusion of premium payments from Indiana AGI for employees is summarized in the table below.

Source	**FY 2008**	**FY 2009**	**FY 2010**	**FY 2011**
Employer Health Benefit Plan Tax Credit*	(0.6 M)	(0.6 M)	(0.6 M)	0
Employee Health Benefit Plan Premium Exclusion**	0	0	(4.3 M)	(4.3 M)
Net Revenue Gain (Loss)	(0.6 M)	(0.6 M)	(4.9 M)	(4.3 M)

*Tax credit affects the Adjusted Gross Income Tax, Financial Institutions Tax, and Insurance Premiums Tax.
**Exclusion affects the Individual Adjusted Gross Income Tax.

The bill establishes a tax credit against the Adjusted Gross Income (AGI) Tax liability, Financial Institutions Tax liability, or the Insurance Premiums Tax liability for qualified taxpayers who make at least one health benefit plan available to their employees for the first time after December 31, 2006. To qualify for the tax credit a taxpayer must employ 10 or more full-time employees in Indiana and may not offer health coverage under a self-funded plan that complies with ERISA. In addition, participation by employees in the health benefit plan must be voluntary. The bill defines a "health benefit plan" as a health insurance policy or contract with an HMO that satisfies the requirements of Section 125 of the Internal Revenue Code. Section 125 allows employees (and employers) to pay their share of insurance premiums with pre-tax dollars which reduces the employee's taxable income and FICA and the employer's FICA and unemployment insurance tax payments. Under a Premium Only Plan (POP) which satisfies Section 125 requirements, the employer does not have to pay any portion of the health insurance premium. While the bill allows a qualified taxpayer to pay any or all of the health insurance premium cost, it does not require such payments.

The credit may be claimed in each of the first two years that the health benefit plan is made available to employees. The credit is equal to $50 per employee enrolled in the employer's health benefit plan, up to a maximum of $2,500 per year. An employer claiming the credit must offer health insurance for at least 24 consecutive months after the taxable year in which the health benefit plan is initially offered. The bill contains a "claw-back" provision where employers who fail to meet this requirement have to pay back the tax credit. The credit is nonrefundable, but unused credit may be carried forward to subsequent years. The tax credit may not be carried back to previous years. In addition, the bill requires that an employer claiming the credit notify employees who participate in the health benefit plan of the amount of the employee's eligible benefits that are included in the employee's Indiana AGI for the first and second taxable years after the employer takes the credit. Eligible benefits are the total amount of health insurance premiums excluded from the employee's federal AGI. The credit is available beginning January 1, 2007, thus the fiscal impact could potentially begin in FY 2008.

The impact the health benefit tax credit is a function of the number of employers with 10 or more Indiana employees that are currently <u>not</u> providing a health benefit plan to their employees, but in the future choose to offer a health benefit plan and claim the tax credit. Estimates based on recent survey research suggest that there are approximately 7,963 Indiana businesses with 10 or more employees that do not offer a health benefit plan. Of these businesses, a number of them would have sufficient tax liability to utilize the entire credit in a given year. The health benefit plan tax credit is estimated to decrease the tax liabilities of employers by $0.6 M in FY 2008 and FY 2009. The carryforward for each year is estimated to total $0.3 M, which could potentially be used in FY 2010. Depending on the extent that employers in the above-described cohort delay initially offering health benefits to employees until years after 2007, some portion of the FY 2008-FY 2010 tax credits and premium exclusions could be shifted to a later period. In addition, the tax credit and premium exclusion totals in FY 2009 and after could be increased if additional employers with 10 or more employees arise due to business start-ups or business expansions in 2008 and after.

The employee's use of pre-tax dollars to pay the premium costs of the health benefit plan would decrease revenue from the Individual AGI Tax. As a result, the bill provides that premiums paid with pre-tax dollars by employees participating in the health benefit plan must be added back to the employee's Indiana AGI for the first two years after the health benefit plan is offered. After the initial two years, these amounts are to be excluded from Indiana AGI. It is estimated that the exclusion of premium payments from Indiana AGI for employees could potentially reduce AGI tax revenue by about $4.3 M annually beginning in the third year of the program (FY 2010).

Revenue from the Corporate AGI Tax, Financial Institutions Tax, and Insurance Premiums Tax is deposited in the state General Fund. Eighty-six percent of the revenue from the Individual AGI Tax is deposited in the state General Fund, and 14% is deposited in the Property Tax Replacement Fund.

Insurance Premiums Tax Impact: The health benefit plan credit could potentially increase revenue from the Insurance Premiums Tax as health insurance premiums written in Indiana increase. *The potential increase in the Insurance Premiums Tax is estimated at approximately $1.5 M per year.* Depending on the extent that employers currently <u>not</u> offering health benefits delay initially offering health benefits to employees until years after 2007, some portion of the FY 2008-FY 2010 premiums tax impact could be shifted to a later period. In addition, the premium tax impact in FY 2009 and after could be increased if additional employers with 10 or more employees arise due to business start-ups or business expansions in 2008 and after.

Estimates based on recent survey research suggest that the average annual premium cost for employer-provided health benefits (depending on firm size) ranges from $3,753 to $3,971 for single coverage and $10,226 to

$10,813 for family coverage. The market penetration rate for HMOs in Indiana is estimated to be approximately 11.1%. The Premiums Tax estimate is adjusted using this market penetration rate since HMOs do not pay the Insurance Premiums Tax. The Premiums Tax impact could potentially be lower to the extent that health insurance companies operating in Indiana have unexhausted tax credits carried forward from prior years.

Explanation of Local Expenditures:

Explanation of Local Revenues: (Revised) ***College Savings Plan Deduction:*** Because the deduction for college savings contributions would serve to decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes.

Employer Health Benefit Plan Tax Credit/Employee Premium Exclusion: The bill requires that the employees of employers claiming the health benefit plan tax credit add back the value of the employee's health benefit contribution to AGI for the first two years after the health benefit plan is offered. Therefore, the bill will have no impact on local option income tax revenues for these two years. After that, the value of the employee's health benefit contribution would be excluded from AGI. This would decrease taxable income for these employees. As a result, counties imposing a local option income tax (CAGIT, COIT, CEDIT) would experience an indeterminable decrease in revenue from these taxes beginning two years after businesses have taken the credit.

State Agencies Affected: Department of State Revenue. State Colleges and Universities.

Local Agencies Affected: Counties with local option income taxes.

Information Sources: Susan Loftus, Indiana Education Savings Authority, (317) 232-5259.Kaiser Family Foundation, *Employer Health Benefits 2005 Annual Survey* & *State Health Facts Online* available at http://www.kff.org. OFMA Corporate Income Tax database. U. S. Census Bureau, *County Business Patterns, 2003*. *Independent 529 Plan*, http://www.independent529plan.org. *College Savings Plans Network*, http://www.collegesavings.org. *Saving for College*, http://www.savingforcollege.com. *2006 U.S. Master Tax Guide*, 239-240.

Fiscal Analyst: Jim Landers, 317-232-9869.